

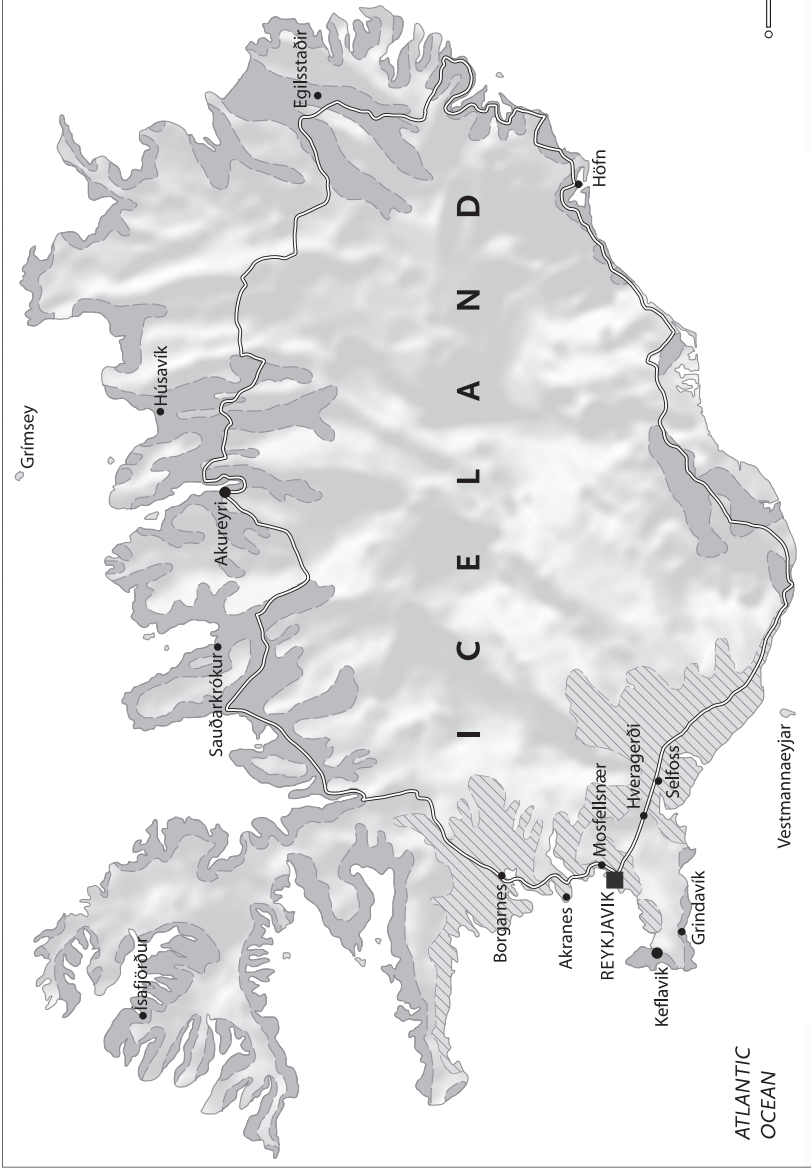
LESSONS FROM ICELAND

Negative reports on the Icelandic economy, as published in several foreign newspapers recently, come as a surprise to us . . . All indicators and forecasts are consistent that the prospects are good, that the situation in the economy is by and large strong and the banks are sound. This has been thoroughly confirmed by well-known scientists such as Frederic Mishkin, who has become a governor of the US Federal Reserve, and Richard Portes, a well-known academic expert in this field.

Prime Minister Geir Haarde, March 2008¹

IN 2007, AVERAGE income in Iceland was almost \$70,000 per annum, the fifth highest in the world and 160 per cent of that of the United States. Reykjavik's shops brimmed with luxury goods, its restaurants made London look cheap, and SUVs choked its narrow streets. Icelanders were the happiest people in the world, according to an international study in 2006. Much of this prosperity rested on the super-fast growth of three Icelandic banks. They rose from small, utility institutions in 1998 to join the ranks of the world's top three hundred banks eight years later, increasing their 'assets' from 100 per cent of GDP in 2000 to almost 800 per cent of GDP by 2007, a ratio second only to Switzerland's. As the value of their houses soared, Icelanders also loaded up on debt, including foreign-currency debt, living out Plautus's dictum: 'I am a rich man, as long as I do not repay my creditors'.

The crisis hit at the end of September 2008, as the money markets seized up in the wake of the Lehman meltdown. Within a week, Iceland's three big banks collapsed and were taken into public ownership. They now joined a less glorious league—Moody's list of the eleven biggest financial collapses in history. Since then Iceland has been pioneering an uncontrolled experiment in how a modern economy can function in a combined currency crisis, banking crisis and sovereign-debt crisis. By



November 2008 the Icelandic króna had fallen to 190 to the euro, from a previous exchange rate of around 70—a massive cut in the islanders’ purchasing power. The foreign-exchange market stopped working, and world currencies were available only for government-approved imports. The stock market plunged by about 98 per cent, and by March 2009, the banks’ senior bonds were trading at between 2 and 10 per cent of their face value. Average gross national income fell from 1.6 times that of the United States to 0.8 times in February 2009, at market exchange rates. These are measures of a calamity.

Iceland is interesting partly because it is an unusually ‘pure’ example of the larger dynamics that produced the rising levels of financial fragility across the developed world through the 1990s and 2000s. In many countries the finance sector grew relative to the rest of the economy, thanks to a combination of three factors: the ‘post-Bretton Woods’ architecture of floating exchange rates and free capital movements; the internet; and surging concentrations of income and wealth in the top few percentiles of the population in the advanced-capitalist countries and several other major economies, including China and India, that raised the demand for complex financial instruments in which to store their accumulating funds. In earlier periods when finance was in the driving seat—for example, at the start of the twentieth century, in the Belle Epoque—financiers retained close ties to production. They sat on the boards of the great electrical, chemical, metallurgical, railroad and shipping conglomerates; they helped to create oligopolies and decide where to invest in production. The difference this time, especially after the high-tech crash of 2000, is that finance in the driving seat has been able to generate giant profits and remuneration ‘within itself’, by ‘casino economy’ operations far from production.

Then the positive-feedback loop kicked in, as many governments—notably those of Britain and the US, home to the City of London and Wall Street—became more beholden to their financial industries than

¹ Geir Haarde, speech to the 2008 annual meeting of the Central Bank of Iceland, quoted in the report of the Special Investigation Commission, *Causes and the run up to the collapse of the Icelandic banks in 2008*, vol. 1, ch. 5, sec. 3, Reykjavik 2010, p. 216; henceforth, SIC Report. This 9-volume, 8kg report is an invaluable source of information, though one has to read between the lines to sense the John le Carré aspects of the story. The government has declined to undertake an English translation beyond an executive summary.

to any other sector. Commentators celebrated the ‘great stability’, the apparent success of policymakers in smoothing the ups and downs of the economic cycle and sustaining long periods of non-inflationary growth. Governments’ dependence on the financial sector, and mood of self-congratulation, led them to signal that they would use state revenues to bail out large financial organizations that made ill-judged investment decisions, creating a largely unnoticed danger of ‘moral hazard’. Financiers became confident that ‘we won’t face the downside if we screw up’. They modelled stress tests for only modest levels of difficulty since, as one British banker put it, ‘the authorities would have to step in anyway’ in the event of trouble.² Not only was national oversight ineffective; global regulation, such as Basel rules, was even laxer, or even counterproductive; and within Europe there was little serious cross-border regulation.

In Iceland the problems of financial-casino economy, regulatory capture and moral hazard were intensified, because the economy and population—around 300,000 people—are small and the state, though ‘modern’ in appearance, did not have regulators with specialized knowledge of international banking. Instead, the government relied increasingly on the banks themselves for information about the economy. Furthermore, from the early 1990s the country was ruled by zealous neoliberals, who believed that financial markets were ‘efficient’ and self-adjusting. These were ideal conditions for regulatory capture.

In the relaxed regulatory climate of the Atlantic world in the early 2000s, Iceland’s bankers were able to buy up big-name high-street brands in Britain, Denmark and elsewhere, leveraging up their balance sheets on the back of shaky or even fictitious collateral. They also succeeded in shifting much of the risk onto the countries of their operations, away from Icelanders—a double moral hazard. The weakness of cross-border regulation allowed the banks great latitude, and they faced virtually no international scrutiny before 2006. In the face of market worries, they then mounted a well-organized PR campaign, hiring big-name economists to say that the Icelandic financial system was basically sound. One of the banks established an internet-based service, Icesave, which allowed

² Quoted in Andrew Haldane, ‘Why banks failed the stress test’, 9 February 2009, available on the Bank of England website. Haldane is the Bank’s Executive Director for Financial Stability.

international retail deposits to flood in. The Icelandic state, meanwhile, had nothing like the resources necessary to secure the banks at the size to which it allowed them to grow; although for a long time it managed to assure investors and other governments that it did. But let us start further back, with the story of how Iceland moved from being one of the poorest countries of Western Europe, in 1945, to being one of the richest by the 1990s; and how it then, even more extraordinarily, produced three major international banks.

From rags to riches

As late as the 1850s, Iceland remained a quasi-feudal colony of Denmark, as it had been for many centuries. Between them, the Danish crown and the Lutheran Church owned over half the usable land; the rest was divided between the handful of local landowners who constituted the native ruling class, and owed their wealth to the exploitation of their tenant farmers' labour. Agricultural workers were legally bound to seek all-year employment on a farm, and not permitted to start families until they could prove they had independent means of subsistence; debt bondage was ubiquitous. Neither the colonial power nor the local landlords had any interest in allowing the growth of alternative employment opportunities, so urban development remained stunted and Iceland's fisheries were mainly exploited by its neighbours. The stubborn struggle of subsistence farmers for their land was an important dynamic within the late nineteenth-century national-independence movement, which also had a strong cultural component. The crofters' life was unforgettably portrayed in Halldór Laxness's great novel, *Independent People*.

Independence from Copenhagen was won in gradual stages: home rule in 1904, sovereignty—albeit with semi-dominion status—in 1918. At the start of the twentieth century, after more than six hundred years of foreign rule, Iceland's average per capita income was about half that of Denmark's, and its social structure remained the most feudal of all Nordic countries'. The mechanization and expansion of the trawler fleet, however, slowly began to open up new employment opportunities for agricultural labourers.³ Fishing came to dominate the economy, generating the bulk of Iceland's foreign-currency earnings, and allowing it to develop a growing import-based commercial sector. This in turn

³ Gunnar Karlsson, *Iceland's 1100 Years*, London 2000.

created new urban economic activities: construction, services, light industry. Icelandic capitalism was dominated from the start by a bloc of some fourteen families, popularly known as The Octopus, which constituted both the economic and the political ruling elite. As well as the import sector, The Octopus controlled transport, banking, insurance and fishing—and, later, supplies to the NATO base. For over half a century, it provided most of Iceland's government personnel and divided up public-sector jobs and other spoils of office between its families, who lived like latter-day chieftains.⁴

The inter-war period saw the emergence of the political groupings whose descendants still contend for office in Iceland today. In contrast to the other Nordic countries, where social-democratic parties have generally played a hegemonic role, here the conservative Independence Party has long held sway, often in alliance with the smaller, agrarian Centre Party. This is due in large part to the electoral over-representation of rural areas, enshrined in the Constitution, which the Independence Party has naturally defended tooth and nail. A smaller, fissiparous but vigorous left has always persisted alongside it, however: the early twentieth-century Social Democratic Party split along Second and Third International lines; the radical Common People's Party formed serial alliances with both groupings, and in the post-war period the different socialist groupings—the People's Alliance, the Union of Liberals and Left—as well as the Social Democrats would participate in various short-lived governing coalitions, sometimes with the Independence Party itself. Trade unions and farmers' cooperatives retained some political weight.

After the Second World War the Icelandic economy entered a period of much stronger growth. This was due to a combination of factors: Marshall Plan aid, premised on the existence of a large US–NATO military base; an abundant export commodity—cold-water fish—blessed, as few such commodities are, with high income elasticity of demand; and a very small, highly literate population with a strong sense of national identity. Iceland became more prosperous; it established a welfare state, in line with the tax-financed Scandinavian model, and by the 1980s had attained both a level and a distribution of disposable income equal to the

⁴ Örnólfur Árnason, *Á slóð Kolkrabbans; Hverjir eiga Ísland?* [In the Realm of the Octopus: Who Owns Iceland?], Reykjavík 1991; Guðmundur Magnússon, *Eimskip frá upphafi til nútíma: Saga Eimskipafélags Íslands* [Eimskip from the Start to the Present: The History of Eimskipafélag Islands], Reykjavík 1998.

Nordic average. Yet it remained both more regulated and more clientelist than its European neighbours; the local oligopoly dominated—and restricted—both the polity and the economy.

A direct line of descent could be traced from the quasi-feudal power structures of the nineteenth century to those of the modernized Icelandic capitalism of the late twentieth. Political leaders acted as heads of long patronage chains, controlling access to jobs and credit. The local (state-owned) banks were effectively run by the dominant parties: the Independence Party controlled appointments and creditor arrangements at the National Bank of Iceland (Landsbanki); the Centre Party performed the same role for the Agricultural Bank (Búnaðarbanki). Ordinary people had to go through party functionaries in order to get loans to buy a car, or foreign exchange for travel abroad. The Octopus controlled the media and decided on senior appointments in the civil service, police and judiciary. Market transactions became political and personal, as credit and jobs were allocated by calculation of mutual advantage. Power networks became tangled webs of bullying, sycophancy and distrust, permeated with a masculinist culture that celebrated the strength of one's hairy right arm.

In the late 1970s and early 80s this traditional order was challenged from within, by a neoliberal faction known as the Locomotive group. It had first coalesced in the early 70s, when some Law and Business Administration students at the University of Iceland took over a journal called *The Locomotive* to promote free-market ideas—and, not least, to open up career opportunities for themselves, rather than wait for Octopus patronage. With the end of the Cold War they found their position strengthened materially and ideologically, as the communists and social democrats lost public support.⁵ The future Independence Party prime minister, Davíð Oddsson was a prominent member of the group. Born in 1948, Oddsson was a bullying *bon viveur* from a middle-class background who was elected as an Independence Party councillor to the Reykjavik Municipal Council in 1974; by 1982 he was Mayor of Reykjavik, leading privatization campaigns—including the sell-off of the Municipality's fishing fleet—to the benefit of his Locomotive cronies. In 1991 Oddsson led the Independence Party to victory in the general

⁵ The Locomotive group functioned as a 'shadow elite' in the sense used by Janine Wedel in *Shadow Elite*, New York 2009.

election. He reigned—not too strong a word—as Prime Minister for the next fourteen years, overseeing the dramatic growth of Iceland’s financial sector, before installing himself as Governor of the Central Bank in 2004. His Locomotive group protégé Geir Haarde, Minister of Finance from 1998 to 2005, took over as Prime Minister shortly after.

Gearing up

The liberalization of Iceland’s economy began in 1994, when accession to the European Economic Area—the free-trade bloc of the European Union countries, plus Iceland, Liechtenstein and Norway—lifted restrictions on cross-border flows of capital, goods, services and people. The Oddsson government then embarked on a programme of selling off state-owned assets and deregulating labour.⁶ Until the late 1990s, however, the financial sector remained small and consisted mainly of publicly owned banks. Privatization began in 1998, implemented in cronyist fashion by Oddsson and Halldór Ásgrímsson, the leader of the Centre Party: Landsbanki was allocated to Independence Party grandees, Kaupthing to their counterparts in the CP, its coalition partner; foreign bidders were excluded. Later a new private bank, Glitnir, was formed from the merger of several smaller ones, with the Ásgeir family as its major shareholder. The new owners of the banks, and their friends, also set up private-equity companies—FL Group, Exista, Samson, Baugur—which, in turn, bought large shareholdings in the three banks. None of these newly minted bankers had much experience in national, let alone international, finance.

The resulting banking system was intensely concentrated—much more than those of the other Nordic countries; it faced no internal competition

⁶ An unintended consequence of liberalizing Iceland’s ‘insider system’ in the 1990s was the emergence of a third capitalist group, outside the Octopus and Locomotive cliques. This included self-made businessmen, who had exploited opportunities in post-communist Russia, and supermarket millionaires, who had managed to bypass the Octopus wholesalers. (Supermarket retailing was an excellent cash cow, because the owners received cash on sale but did not pay suppliers for 90 days.) Oddsson and the Independence Party bosses were outraged when these newcomers failed to respect ‘the rules’—Jón Ásgeir, the leading figure of the insurgents, insisting that if he had to contribute money to the Independence Party he would contribute equal amounts to its rivals. Oddsson and his henchmen publicly disparaged the Ásgeirs as ‘the barrow boys’, referring to their non-establishment origins. Much of his time as Prime Minister was spent plotting how to bring them down. For details—and for a riveting narrative account of the whole Icelandic saga—see Roger Boyes, *Meltdown Iceland*, London 2009.

from foreign banks and, despite being ‘private’, remained closely linked to politicians. At the turn of the millennium, Iceland roared into international finance aided by two global conditions—abundant cheap credit (thanks to US deficits) and free capital mobility—and three domestic ones: strong political backing for the banks; investment banking merged with commercial banking, so that the former shared the guarantees that the government extended to the latter; and low sovereign debt, which yielded the banks the all-important imprimatur of a high mark from the international credit-rating agencies. Thus empowered, the major shareholders of Landsbanki, Kaupthing, Glitnir and their various spin-offs reversed the earlier political dominance of finance: government policy was now subordinated to their ends.

Oddsson’s larger strategy saw finance as the third wheel of the economy, together with fishing and energy (especially for aluminium smelting). In 2001 his chief economic and political advisor produced a paper entitled, ‘How to make Iceland the richest country in the world’, which envisaged the country as a tax-haven, on the model of Luxembourg, Jersey, Guernsey and their Caribbean counterparts. Work began on a huge, publicly financed hydro-electric dam, one of the biggest construction projects in Europe; it was followed by a massive, privately financed aluminium smelter, owned by Alcoa, and the major expansion of another one. These projects generated huge capital inflows and pushed the trade deficit sky high. Oddsson and friends then relaxed the state-provided mortgage rules, allowing loans for 90 per cent of a property’s value. The newly privatized banks rushed to offer even more generous terms. Income tax and VAT rates were lowered, in line with the strategy of turning Iceland into a low-tax international financial centre. Bubble dynamics soon took hold.⁷

Iceland’s new banking elite rode the bubble, intent on expanding their ownership of the country’s economy, both competing and cooperating with each other. Using their shares as collateral, they proceeded to take out large loans from their own banks, some of which they spent on buying more shares in the same banks, inflating share prices. Their executives were instructed to follow suit. They performed the same task for other clients, including the other banks. Bank A lent to shareholders in Bank B, who bought more shares in B against the shares as collateral, raising B’s share price. Bank B returned the favour for shareholders in Bank A. The

⁷ SIC Report, vol. 1, ch. 4, sec. 3, pp. 97–129.

net result was that the share prices of both banks rose, without new money coming in. Depositors, too, were urged to shift their savings into shares, and bank employees spent their evenings telephoning households up and down the country to this end, using tactics that could only be described as predatory lending. The result was to shield major shareholders from risk while yielding them a percentage of the very high profits.

Much of this was ‘Ponzi’ finance, in which the debt could only be refinanced by further borrowings; much of it rested on fake capital, the result of illegal market manipulation. But the unsustainability of the process remained hidden, as the banks established elaborate carousels of co-owned companies in places like Luxembourg, the Isle of Man, the British Virgin Islands, even Cuba, that bought each other’s shares and leveraged up each other’s balance sheets. With their self-dealing concealed, Iceland’s financial institutions seemed to have increasingly strong balance sheets, at least to the inexpert or the incurious. Brokers criss-crossed the country, persuading households to load up on more debt and to convert new or existing króna debt into much lower-interest Swiss francs or Japanese yen. They assured their clients that this was ‘a no-brainer’—‘the króna would have to fall by more than 20 per cent for it not to be, and that’s not going to happen’. The super-abundance of credit allowed people to consume in extravagant celebration of their escape from the earlier decades of credit rationing through political connections. It allowed them to see themselves as ‘independent people’ at last—which may help to explain their ‘happiest in the world’ ranking.

It was by these means that tiny Iceland managed to enter the big-bank league. By the end of 2007, as noted, the combined ‘assets’ of Landsbanki, Kaupthing and Glitnir had increased to almost 800 per cent of GDP. The owners and managers remunerated themselves on an ever-larger scale, effectively robbing the banks from the inside. As they grew richer, they attracted more political support; many came to believe they had the Midas touch. Their private jets, roaring in and out of Reykjavik’s airport, seemed to provide visual and auditory proof to the part-admiring, part-envious population below. Income and wealth inequality surged, helped by government policies that shifted the tax burden to the poorer half of the population.⁸ In the mid-90s, the pattern of overall disposable-income

⁸ Stefán Ólafsson and Arnaldur S. Kristjánsson, ‘Income Inequality in a Bubble Economy: The Case of Iceland 1992–2008’, Luxembourg Incomes Study Conference paper, June 2010.

distribution was comparable to the—relatively egalitarian—Nordic average; in 2007 it was on a par with that of the United States, the most unequal in the developed world.

The bankers reciprocated with large financial contributions to the governing parties. In the run-up to the 2007 election, contributions to the Independence Party amounted to \$77 per vote cast for it; the smaller Centre Party received \$202 per vote cast, not including contributions to individual candidates. Most of the money came from the banks and the fishing barons.⁹ The banks also made large loans to individual politicians: ten of the Althing's 63 MPs took out loans of over 100 million krónur—roughly \$1.5m—between 2005 and 2008.¹⁰ It is thought likely that over half the MPs had loans exceeding 50 million krónur. The Oddsson government, the banks, Iceland's Chamber of Commerce and other bodies mounted a well-orchestrated campaign to present the country as an emerging international financial centre, conveniently situated mid-way between Europe and America.¹¹ The leading Icelandic champion of free-market economics cheered Oddsson's government in the *Wall Street Journal* for pushing through a liberalization process comparable to that of Pinochet's Chile. The Iceland Chamber of Commerce suggested that Iceland 'stop comparing itself with the other Nordic countries—after all we are in many ways superior to them'.¹²

Tremors

In early 2006, however, worries began to surface in the financial press about the stability of the big banks, which were beginning to have problems raising funds in the money markets. Iceland's current-account deficit had soared from 5 per cent of GDP in 2003 to 20 per cent in 2006, one of the largest in the world. The stock market multiplied itself nine times over between 2001 and 2007. Landsbanki, Kaupthing and Glitnir were operating far beyond the capacity of Iceland's Central Bank to

⁹ Parties in the other Nordic countries do not accept funds from corporations.

¹⁰ SIC Report, vol. 2, Ch.8, sec. 11.2, p. 200, Table 23. One hundred million krónur was more than six times the average household debt at the time.

¹¹ Oddsson had discussed this idea in an interview a few years earlier: see 'Iceland warms to offshore banking', *Financial Times*, 7 April 1998.

¹² See Hannes Gissurason, 'Miracle on Iceland', *Wall Street Journal*, 29 January 2004 [reference corrected 21 January 2014]; and Icelandic Chamber of Commerce, *Vidskiptathing Íslands 2015*, February 2006, p. 22.

support them as lender of last resort; all the more so since, though their liabilities were real, many of their assets were dubious, and a high proportion of both were denominated in foreign currencies.¹³ In February 2006, Fitch downgraded Iceland's outlook from stable to negative. This triggered what became known as the 2006 'mini-crisis': the króna fell sharply, the value of banks' liabilities in foreign currencies rose, the sustainability of foreign-currency debts became a 'public' problem, the stock market fell and business defaults rose.

The IMF's 2006 country report on Iceland sounded a warning note. The published version began by saying 'Iceland's economic prospects are enviable'. But it went on to qualify the upbeat tone, noting, for example, 'vulnerabilities' that included 'considerable near-term refinancing needs, credit quality, the long-term sustainability of the banks' presence in the domestic mortgage market, and the crossholdings of equity'.¹⁴ Several Icelandic economists warned of big dangers ahead, while the Danske Bank of Copenhagen described Iceland as a 'geyser economy', on the point of exploding.¹⁵ Icelandic bankers and politicians brushed aside the 2006 'mini-crisis' as the result of ignorance. They kept quoting the opening sentence of the IMF report, 'Iceland's economic prospects are enviable', ignoring the later qualifications. Iceland's Central Bank took out a loan to double the foreign-exchange reserves, while the Chamber of Commerce—run, of course, by cronies and representatives of Landsbanki, Kaupthing, Glitnir and their assorted spin-offs—responded with a PR campaign. An expensive report was commissioned from the Columbia Business School economist Frederic Mishkin, which affirmed the stability of the banks with few qualifications.¹⁶ The following year the Chamber of Commerce commissioned another report from Richard

¹³ Willem Buiters and Anne Sibert, 'The Icelandic banking crisis and what to do about it', Centre for Economic Policy Research, October 2008.

¹⁴ IMF, *Staff Report: Iceland*, 13 July 2006. The internal version was more critical, but Prime Minister Haarde and the Finance Minister insisted it be toned down, and the IMF complied. Thus the internal draft described Icelandic banks' balance sheets as growing 'at a staggering pace'; the published version merely 'a remarkable pace'.

¹⁵ Danske Bank, 'Iceland: Geyser Crisis', 2006.

¹⁶ Frederic Mishkin and Tryggvi Herbertsson, 'Financial Stability in Iceland', Reykjavik 2006. Mishkin was paid a fee of \$135,000 for this 35-page report. After September 2008 the paper appeared on Mishkin's CV as 'Financial Instability in Iceland'. Questioned about the title change by documentary film-maker Charles Ferguson, Mishkin dismissed it as a typographical error. See Ferguson's *Inside Job*, 2010, and 'Mishkin resigns: a look back', *Wall Street Journal*, 28 May 2008.

Portes of the London Business School, which reached virtually the same conclusion. Portes and his Icelandic collaborator left the lender-of-last-resort question to the end and then dismissed it in half a page. This was not a question the Chamber or the Reykjavik bankers behind it wanted asked, because the answer was glaringly obvious: the value of the banks' 'assets' at this stage was around eight times greater than Iceland's GDP.¹⁷

Mishkin dismissed the Danske Bank report, saying that it 'talked of Iceland as an emerging-market economy, vulnerable in the same way those economies are vulnerable. When you look closely at the analysis, that view does not hold up.' Portes reiterated that the Icelandic banks had no cause to worry about the 'fundamental soundness' of their business model: 'I think it is very sound and very good'—any 'market turmoil' was 'just prompted by some misplaced misunderstandings' of market analysts.¹⁸ By now Landsbanki, Kaupthing and Glitnir were reliant on short-term borrowings for two-thirds of their total funding. The supply-side economist Arthur Laffer assured the Icelandic business community in late 2007 that fast economic growth with a large trade deficit and ballooning foreign debt were signs of success: 'Iceland should be a model to the world'.¹⁹ The Prime Minister duly informed the 2008 annual meeting of the Central Bank that such eminences as Mishkin and Portes had 'thoroughly confirmed' that economic prospects were good and the banks sound, as quoted in the epigraph to this essay.

IP–SDA coalition

The Icelandic left had meanwhile undergone a series of splits and regroupings. In 1999 the Social Democratic Party, Women's List and a section of the People's Alliance—earlier, a left critic of both NATO and the Warsaw Pact—united in a centre-left list, the Social Democratic Alliance, in a bid to open up a 'normal' two-party system. The People's Alliance left, for its part, joined with the environmentalists to form a Left–Green Movement. One indicator of the left's moral stature has been the repeated re-election of the political scientist Ólafur Ragnar Grímsson, chairman

¹⁷ Richard Portes and Friðrik Baldursson, 'The Internationalization of Iceland's Financial Sector', Reykjavik 2007. Portes's fee for the 65-page report was £58,000: SIC, v. 8, Annex III, p. 3.

¹⁸ The quotes, recorded in 2006 and 2007 respectively, are from Gunnar Sigurðsson's excellent 2010 film about the Icelandic crisis, *Maybe I Should Have*.

¹⁹ Arthur Laffer, 'Overheating is not dangerous', *Morgunblaðið*, 17 November 2007.

of the People's Alliance from 1987 to 1995, as Iceland's President. First elected President in 1996, and returned to office in 2000, 2004 and 2008, Grímsson was a consistent opponent of Oddsson's foreign policy, not least its avid support for Bush's 'Coalition of the Willing' in Iraq. In the Althing elections of 1999 and 2003, the SDA won 17 and 20 seats, respectively, with a 26–31 per cent share of the vote. The Left–Green Movement, with around 10 per cent of the vote, won 6 seats in 1999 and 5 in 2003. Against this, the governing Independence Party–Centre Party coalition had a combined total of 50–60 per cent of the vote, with 38 seats between them in 1999 and 34 in 2003—a working majority in the 63-seat Althing.

The elections of May 2007, however, saw the Centre Party fall from 12 seats to 7, with just under 12 per cent of the vote—beaten into fourth place by the LGM, which won 9 seats and over 14 per cent of the vote. The SDA, with 18 seats and nearly 27 per cent of the vote, seized the opportunity to profit from the Centre Party's lacklustre performance—and share in the prosperity—by itself entering a coalition government with the still-dominant Independence Party (25 seats, 37 per cent of the vote). To the consternation of many of its supporters, SDA leaders ditched their pre-election pledges and gave a ringing endorsement to the continued expansion of the financial sector.²⁰

By this time the inner circle of government could no longer ignore the evidence that the balance sheets of the banks might be cans of worms, and that the interconnectedness of the banks was such that if one failed the others might fail too. Senior ministers established an ad hoc coordination group with officials from the Prime Minister's Office, the Ministry of Finance, Ministry of Banking and Commerce, the Central Bank and the Financial Supervisory Authority of Iceland (FME). The group was to share information and make a contingency plan in the event of a financial crisis. But it had no clear mandate or formal procedures and did little more than throw ideas around. The chair—the Permanent Secretary of the Prime Minister's Office—was notably unenthusiastic about planning

²⁰ The 2007 IP–SDA coalition agreement states: 'The transformation of the Icelandic economy in recent years involves amongst other things increased emphasis on provision of various international services, such as financial services. The government aims to ensure that such services continue to grow here in Iceland and expand into new areas in other markets'. Quoted in SIC Report, vol. 1, ch. 5, sec. 5.2, p. 210. Electoral data from Economic Intelligence Unit, 'Iceland: Country Profile 2008'.

crisis measures. The Special Commission later determined that the group did not report to ministers in any way that could be verified, allowing the latter to evade legal responsibility and later to deny that they knew how serious the problem was becoming.²¹ There was no move by the IP–SDA coalition to strengthen the banks’ regulatory framework.

Launching Icesave

Though they had survived the 2006 mini-crisis, Landsbanki, Kaupthing and Glitnir were still carrying huge mismatches between their assets—mostly illiquid, with long maturities—and their short-term liabilities. They continued to have trouble raising money to fund their asset purchases and repay existing debt, largely denominated in foreign currencies. The banks hit upon two methods of solving this problem. The first, pioneered by Landsbanki, was Icesave, an internet-based service that aimed to win retail deposits by offering more attractive interest rates than the high-street banks. Established in Britain in October 2006, and in the Netherlands eighteen months later, Icesave caught the attention of ‘best buy’ internet finance sites and was soon flooded with deposits. Tens of millions of pounds arrived from Cambridge University, the London Metropolitan Police Authority, even the UK Audit Commission, responsible for overseeing local government funds.

Staff at Landsbanki could hardly believe their good fortune as they watched the numbers going up on their computer screens. There were 300,000 Icesave depositors in Britain alone. The inflow allowed the bank to repay its loans and buy more assets. The fact that the Icesave entities were legally established as ‘branches’ rather than ‘subsidiaries’ meant that they were under the supervision of the Icelandic authorities, rather than their hosts. No one worried much that—because of Iceland’s obligations as a member of the EEA deposit insurance scheme—its population of 320,000 would be responsible for compensating the depositors abroad in the event of failure, while Landsbanki’s shareholders reaped the short-term profits. The other banks, Kaupthing and Glitnir, rushed to get in on the action: in May 2008 alone the regulator received ten applications to establish similar entities abroad.

The second ‘solution’ to the Icelandic banks’ difficulties in raising new funds came to be known as ‘love letters’—a novel way to get access to

²¹ SIC Report, vol. 6, pp. 69–245.

liquidity without pledging real assets as collateral. Having exhausted their borrowing capacity from Iceland's Central Bank, the Big Three would sell debt securities to one of the smaller regional banks, which would take these bonds to the Central Bank and borrow against them, without having to supply further collateral; they then lent back to the initiating big bank. The bonds were quickly dubbed 'love letters' in the trade—mere promises. The banks then internationalized the process. Buoyed by their 'strong' balance sheets, the Big Three established subsidiaries in Luxembourg and sold 'love letters' to them. The subsidiaries sold them on to the Central Bank of Luxembourg or the European Central Bank and received cash in return, which they could pass back to the parent bank in Iceland or else use themselves. Between February and April 2008, Landsbanki, Kaupthing and Glitnir increased their borrowings from the Central Bank of Luxembourg by €2.5bn; by the end of June the sum had risen by another €2bn. Of course, none of the Central Banks—Icelandic, Luxembourgish or European—should have accepted one Icelandic bank's debt as collateral against another's borrowing, given their co-dependence.²² Remarkably, at least one of the big banks, Glitnir, received a AAA rating for its bonds from a US credit-rating agency, higher than that of Iceland itself.

Political and regulatory support continued at the highest levels. In March 2008, the IP-SDA government put on yet another PR event for the Big Three in the form of a 'road-show' in Copenhagen, at which Richard Portes and Iceland's SDA Foreign Minister, Ingibjörg Gísladóttir, affirmed the soundness of the country's financial system.²³ (Later, Gísladóttir would claim that banking was the responsibility of the—fellow SDA—Minister for Banking, not in her jurisdiction.) Prior to Icesave's Netherlands launch in May 2008, Landsbanki published a prospectus in which the Chairman of Iceland's Financial Supervisory Authority also announced his confidence in the sector's stability. Such regulatory capture was endemic to the financial system.

²² Anne Sibert, 'Love letters from Iceland: accountability of the Eurosystem', *VoxEU*, 18 May 2010. The Central Bank of Luxembourg menacingly requested the Central Bank of Iceland to remove a link to Sibert's paper from its website.

²³ From the summer of 2005 onwards, Wade gave several public talks in Iceland, warning about the build-up of financial fragility and drawing parallels with the run-up to the East Asian crisis of 1997–98; he was consistently greeted with polite dismissal. See 'Iceland pays the price for financial excess', *Financial Times*, 2 July 2008, and the letter in response from Richard Portes and Friðrik Baldursson, which began, 'Robert Wade gets Iceland very wrong': *Financial Times*, 4 July 2008.

Yet by this stage, many months into the credit crunch, European central banks and the IMF were fully aware of the gathering crisis in Iceland and the international risks it posed. In mid-April 2008 the IMF sent a confidential report to the Haarde government on the need to rein in the banks and how to go about it. In the same month Mervyn King, Governor of the Bank of England, offered Oddsson help in scaling down the banking system, but there was no reply. The Central Bank of Iceland had concluded that scaling down was impossible, and sought only to borrow more foreign-exchange reserves. In May 2008, aware of what an implosion in Reykjavik would do to their own financial sectors, the Central Banks of Denmark, Sweden and Norway reluctantly responded to desperate Icelandic entreaties for credit lines, extracting in return a secret pledge from ministers and Central Bank of Iceland governors to carry out a programme similar to the IMF's of the month before.²⁴ By 15 September 2008, when Lehman Brothers fell, virtually none of it had been put in place.²⁵

The crisis hits

The fall of the Icelandic banks came two weeks later. On 29 September, Glitnir approached Governor Oddsson at the Central Bank for help with its looming liquidity problem. In a bid to restore confidence, Oddsson instructed the Central Bank to buy 75 per cent of Glitnir's shares. The effect, however, was not to boost Glitnir but to undermine confidence in Iceland. The country's rating plunged, and credit lines were withdrawn from Landsbanki and Kaupthing. A run on Icesave's overseas branches began. As the collapse gathered speed, Oddsson moved on 7 October 2008 to peg the króna to a basket of currencies at close to the pre-crisis rate and simultaneously lowered the interest rate (which amounted to pouring petrol on the raging fire). He consulted no one save his protégé, Haarde. Even the Central Bank's chief economist was kept in the dark. In conditions where the currency was already tumbling, the foreign-exchange reserves were exhausted and there were no capital controls, the peg lasted for only a few trading hours; it was perhaps the shortest-lived

²⁴ SIC Report, vol. 1, pp. 223–4.

²⁵ In a final bid to keep the show on the road, Kaupthing announced with great fanfare that a member of the Qatari royal family had bought a 5 per cent stake in the bank, signalling international confidence; it turned out subsequently that the prince had put up no money of his own—Kaupthing had lent it to him, through a third party.

currency peg ever. But it was long enough for cronies-in-the-know to spirit their money out of the króna at a much more favourable rate than they would get later. Inside sources indicate that billions fled the currency in these hours.²⁶ Then the króna was floated—and sank like a stone. On 8 October Gordon Brown muscled in to freeze Landsbanki's UK assets under New Labour's anti-terrorism laws.²⁷ From a peak of around 70 to the euro, the króna, as we have seen, would hit 190 in November 2008. The stock market, bank bonds, house prices and average income went into free-fall.

The IMF arrived in Reykjavik in October 2008 to prepare a crisis-management programme, the first time the Fund had been called in to rescue a developed economy since Britain in 1976.²⁸ It offered a conditional loan of \$2.1bn, to stabilize the króna; the Nordic Central Banks were persuaded to swallow their anger and pledge another \$2.5bn, again with conditions. The IMF approved stringent foreign-exchange controls to stop capital from fleeing; the carry-trade money locked up in króna denominated 'glacier bonds', estimated at about half of Iceland's 2008 GDP, was keen to escape. Interest rates were initially raised to 18 per cent, but soon reduced to their original 15 per cent again. Fiscal tightening was scheduled for 2010–2011. The IMF also backed the British and Dutch governments' demands that Iceland recompense them for their

²⁶ The currency peg has been strangely neglected in the investigation of Iceland's collapse. The mix of panic, ignorance and tactics behind it is not clear. The Governor told the media that he had secured a loan from the Russian Central Bank (big enough, implicitly though not explicitly, to secure the peg); but almost immediately there came an angry Russian denial. The tactic may have involved more than just the opportunity for friends to get their money out of the króna. Senior figures may also have calculated that bringing down Kaupthing, the one bank that looked as if it might survive, would be sweet revenge on the principle of 'If my bank has gone down, yours is coming down too'. At a dinner during the 2007 IMF Annual Meeting in Washington DC, it is known that Oddsson jabbed his finger at Kaupthing's Chairman and said that, if the bank started to denominate its transactions in euros, 'I will take you down'. The currency peg allowed an outflow from Kaupthing, still linked to the Centre Party and rival big men. Landsbanki, with close ties to the Central Bank Governor and the Independence Party, had collapsed just before the peg was introduced. These are murky waters.

²⁷ Jon Danielsson and Gylfi Zoega, 'The collapse of a country', *Risk Research*, 12 March 2009.

²⁸ International Monetary Fund, *Iceland: Request for Stand-By Arrangement*, 25 November 2008. By happy coincidence, the IMF economist appointed to head the office in Reykjavik was Geir Haarde's room-mate at Brandeis in the 1970s.

bail-outs of Icesave depositors, up to the ceiling of the European deposit-guarantee scheme, that is, €20,887 per account.

Iceland's normally placid and consumption-driven population erupted in an angry and adrenalized protest movement, principally targeted at Haarde, Oddsson and their Independence Party cronies, although the SDA's Gísladóttir was considered tarnished, too. Thousands of people of all age groups assembled in Reykjavik's main square on freezing Saturday afternoons to chant, bang saucepans and listen to speeches and songs. Protestors linked arms in a circle around the Althing to demand the government's resignation, and pelted the building with yoghurt and fruit. Every Monday evening, up to a thousand people would cram into Reykjavik's biggest cinema to debate the situation. Petulant government ministers were forced to respond to their questions. Yet the ruling elite kept trying to carry on 'as normal', concealing their conflicts of interest as mere coincidences of personnel. Thus, for example, the Haarde government saw no problem in the fact that the senior State Prosecutor appointed to investigate the banking crisis in December 2008 was the father of the CEO of one of Kaupthing's major holding companies. Similarly, the Justice Minister had seen fit to appoint as Special Prosecutor to the investigation a small-town police chief, whose most notable achievement had been a parking-ticket system.²⁹

Finally, in January 2009, the IP-SDA coalition broke apart, as the Social Democrat leaders took up popular calls for Oddsson to resign as Central Bank Governor, while Haarde still defended his old friend.³⁰ To date, Iceland's remains the only government to have resigned as a result of the global financial crisis. It is also the only country to have shifted distinctly to the left in the aftermath of September 2008. With the Independence Party widely disparaged, and trailing far behind both the SDA and the now highly popular Left-Green Movement in the polls, an interim SDA-LGM government was formed in January 2009 to lead the country until April's

²⁹ The citizens' protest movement demanded that an experienced anti-corruption campaigner, the Norwegian-French Eva Joly, be offered a position as Advisor to the Special Prosecutor. For several months after her appointment in March 2009 Joly was not allocated an office and had to work out of her hotel room.

³⁰ Oddsson was finally forced to resign as Central Bank Governor in February 2009, after angry demonstrations outside the Central Bank building, and the passage of legislation abolishing the current governorships and requiring future incumbents to possess experience of finance and at least a master's degree in economics.

election. Jóhanna Sigurðardóttir, previously the SDA Minister of Social Security and relatively untainted by the crisis, became interim Prime Minister and replaced Gísladóttir as SDA leader. The LGM's Steingrímur Sigfússon became interim Minister of Finance. In the April 2009 election, the SDA won 20 seats and the LGM 14 seats, giving the 'red-red' coalition a narrow working majority. Despite the overwhelming bias of the electoral system in its favour, the Independence Party was reduced to 16 seats, the worst result since its formation in 1929.

The SDA-LGM government came under immediate pressure to repay the crushing Icesave debt, as demanded by the British and Dutch governments; much of the IMF loan was being withheld until Reykjavik agreed to their terms. The Sigurðardóttir government was also divided on whether to apply for full membership of the European Union and Eurozone, with most of the SDA strongly in favour. In addition, Icelanders were expected to repay the giant loan taken out by the Central Bank in 2006, which will mature in 2011. The constraints were all the tighter since the 'love letter' bonds, bought by the Central Bank against no real collateral, effectively rendered it bankrupt. It was recapitalized from the state budget at a cost to taxpayers of 18 per cent of GDP—yet another resource transfer which intensified the existing cuts in public spending on health, education and infrastructure. After long negotiations, Sigurðardóttir and Sigfússon presented the terms they had agreed on the Icesave debt to the Althing, in October 2009: €5.5bn, or 50 per cent of Iceland's GDP, was to be paid to the British and Dutch Treasuries between 2016 and 2023.³¹ There were ructions in the LGM—the party's Minister of Health resigning in protest, five dissidents refusing to vote with the government. The bill was forced through on 30 December 2009, against high feelings in the country. A week later, on 5 January 2010, President Grímsson announced that he would not sign it into law, out of respect for the national sentiment against it. Damagingly for the government, the British and Dutch immediately offered better terms. When the SDA-LGM deal was put to a referendum in March 2010, 93 per cent voted No, less than 2 per cent Yes. Even the SDA-LGM leaders abstained.³² In the May 2010 Reykjavik

³¹ A second tranche of the IMF loan was released in November 2009. The release of a third tranche in April 2010 is said to have been at the insistence of Beijing, against the wishes of London and Amsterdam. On Sino-Icelandic relations see Wade, 'A warmer Arctic needs shipping rules', *Financial Times*, 16 January 2008.

³² New negotiations with Britain and the Netherlands began in the summer of 2010, but at the time of writing the issue remains unresolved.

municipal elections, the SDA slumped to 19 per cent. A comedian was elected as the city's mayor.

Prospects

The postponement of major public-spending cuts until 2011 has given the economy a little breathing-space. So far, Iceland has experienced smaller falls in GDP and employment than big public-spending slashers like Ireland, Estonia and Latvia. The unemployment rate, only 2 per cent in 2006, has hovered between 7 and 9 per cent since the start of 2009; but the rate of outmigration, both of Icelanders and of other (predominantly Polish) European workers, has been the highest since 1889. However, the SDA-LGM government has announced drastic cuts in public spending for 2011. Big construction projects are coming to an end and several of the firms have no new contracts. Local governments have no budget for fresh projects. Hospitals and schools are cutting salaries and beginning to sack employees. The freeze on house reposessions is due to expire in late 2010.

Even after large private-sector write-offs, Iceland's gross public and private foreign debt currently amounts to more than 300 per cent of GDP. Interest payments have already become the biggest item of public expenditure and, as noted, much more debt is coming due. The commercial banks, expensively recapitalized from the public purse, are lending little, preferring to play safe by depositing a large share of their loanable funds with the Central Bank and obtaining a generous interest rate paid, yet again, from the state budget, amplifying the pressure for spending cuts. In addition, in September 2010 Iceland's Supreme Court ruled that the loans indexed to foreign currencies were illegal; the government proposed legislation to cut the debt burden of households, raising the spectre of a second banking collapse. As noted above, these loans were widely promoted to households and companies alike between 2004 and 2008; the principal on them more than doubled when the króna collapsed in 2008. They represent a large share of the restructured banks' and financial companies' portfolios. Meanwhile, a whole variety of entrepreneurial initiatives are under way, as the island seeks to develop new specializations to replace finance; but these are all constrained by the mountain of debt.

The crisis has revealed in stark terms the weakness of accountability. In April 2010 the Special Investigation Commission's report into the

causes of the financial crisis accused three former ministers—Haarde, the prime minister; Árni Mathiesen, the finance minister; and Björgvin Sigurðsson, the minister of banking and commerce—as well as three former Central Bank governors and the Director of the financial regulatory body FME of gross negligence. In September 2010, a parliamentary committee recommended that the three ex-ministers, together with Gísladóttir, the former foreign minister, be charged in the Landsdómur, a special ‘High Court’ never previously convened, with breach of ministerial responsibility. The same committee had suggested to the State Prosecutor’s office in May that the three Central Bank governors and the head of the FME should face criminal charges; but the prosecutor decided within 24 hours that they should not. The Permanent Secretary at the Ministry of Finance was fired, though not for dereliction of official duty but because he had used inside information to sell his large shareholding in one of the banks a few days before the collapse.

The Special Prosecutor’s thirty-strong team, in charge of criminal investigation, has only succeeded in bringing one case—concerning a minor player—to court so far. The governments of Britain and Luxembourg are cooperating, fitfully and hesitantly, perhaps wary of exposing wider wrongdoings at home. The property developer David Rowland and his son are major shareholders in Banque Havilland, the new bank currently being reconstructed on the ruins of Kaupthing’s Luxembourg subsidiary; they are keen to see Iceland ‘move on’ and not keep raking over the past.³³ The Rowlands are also important donors to the British Conservative Party. Far from being held accountable, Oddsson was rewarded in September 2009 with the position of Editor-in-Chief at *Morgunblaðið*, the leading Reykjavik daily, whence he has orchestrated coverage of the crisis—roughly the equivalent, as one commentator has pointed out, of appointing Nixon editor of the *Washington Post* during Watergate.³⁴ The weakness of the current SDA–LGM government will ultimately redound to the benefit of the Independence Party.

Privatized information

What explains the Icelandic debacle? The fall of Lehman Brothers and the resulting paralysis of money markets was the trigger for the final

³³ ‘Rowland family open new bank’, *Daily Telegraph*, 13 July 2009.

³⁴ Thorvalder Gylfason, ‘From Boom to Bust: the Iceland Story’, in Gylfason et al., eds, *Nordics in Global Crisis*, Helsinki 2010, p. 158.

collapse, of course, but a crash would have come anyway, because of the giant structural imbalances and the overreaching of the financiers. In a way, 9.15 was a blessing: if Iceland's Ponzi dynamic had continued for another year, the fall-out when the bubble finally burst might have caused the first complete bankruptcy of a modern nation, and attendant population flight. Undoubtedly, the bankers' wild behaviour was the central factor. It offers a text-book case of accounting control fraud: they '(a) grew like crazy, (b) made really, really bad loans with high yields, (c) were extraordinarily leveraged, i.e. a lot of debt compared to equity, and (d) maintained no significant loss reserves'.³⁵ In the end, however, the responsibility lies with the Reykjavik government and the Central Bank. The parallels with US and UK politicians and central bankers are obvious: as in Iceland, Clinton, Bush and Greenspan, or Blair, Brown and Mervyn King, remained in denial while their policies pumped up the bubbles, year after year.

It might have been thought that Iceland's tiny scale would make it easier to challenge such denial; but if anything, the opposite was true. The Oddsson government undertook an extreme 'privatization' of information, relying primarily on the research departments of the banks themselves for analysis of the economy and its prospects. Landsbanki, Kaupthing and Glitnir paid much better than any government body; they must therefore attract the best talent. People joined the Central Bank or the FME with the aim of learning enough to cross the street and double their salaries. Why not go straight to those most in the know? Iceland's National Economic Institute had built a reputation for independent thinking and, though responsible to the Prime Minister's office, published unwelcome reports, warning that management of the economy was going haywire. Oddsson abolished it in 2002. The Competition Authority was also abolished after it had criticized the activities of the oil-import companies, closely linked to the Independence and Centre Parties. The Confederation of Industry was threatened by a funding squeeze when it argued in favour of joining the European Union, against the line of the Independence Party and the fishing industry.

In the small Icelander system, the ruling elite has long held to the dictum that 'peace produced by fear is the most long-lasting'. Policy debate quickly slides from issues to personalities; disagreement is construed as

³⁵ See William Black, *The Best Way to Rob a Bank is to Own One*, Austin, TX 2005; the quote is from a public lecture by Black at the University of Iceland, 3 May 2010.

disloyalty, and therefore suppressed. Statistics Iceland, the public data agency, was notably cowed into suppressing information on soaring income and wealth inequality, and hardly dared to draw attention to unfavourable trends. The University of Iceland bowed to pressures to make its Economic and Social Research centres self-funding—that is, to rely on finding buyers for commissioned research—with the convenient result that they no longer published big-picture reports with a critical edge. (Again, of course, examples could be found elsewhere.) Iceland's Chamber of Commerce also took an active advisory role, commissioning analyses from 'independent' experts like Mishkin and Portes. Meanwhile, Transparency International's Corruption Perceptions Index continued to rank Iceland as the cleanest public administration in the world, an honour shared with New Zealand and Finland; not till 2009 did Iceland get demoted from Transparency International's number one position.

A counter-intuitive change in the economic information available occurred as the bubble developed. When it initially began to swell—first in mergers and acquisitions in 2003, then in housing in 2004—several critical reports were published, not least by the Central Bank. By 2006, as noted, the IMF was toning down its concerns, at the Prime Minister's request and, presumably, on grounds of avoiding adverse 'market reaction'. But by 2007 and 2008, when the dangers had become acute, the reports, including those from the IMF, became noticeably softer in tone. It seems that the official financial institutions, as well as the bankers and politicians, acted on the understanding that the situation had become so fragile that to speak of it might trigger a run on the banks which might otherwise be averted. Bad news had to be kept out, and those who insisted on presenting it dismissed as alarmist and incompetent.

With independent information centres neutralized, the big players of the financial sector were better able to capture the key Ministries and Central Bank; indeed, in such a small pool, one could say that they had all captured each other. The Chamber of Commerce functioned almost literally as the capitalists' executive committee: it has been estimated that at least 90 per cent of its recommendations were translated into legislation. Almost everything the bankers wanted became government policy, and grateful bankers provided grateful politicians with generous rewards. The IP-SDA government's decision to provide unlimited deposit guarantees after the crash illustrates its ultimate beholdenness to the financial elite. Had it limited the guarantee to 5m krónur, roughly

€50,000, it would have protected the entire deposits of 95 per cent of depositors; only the wealthiest 5 per cent benefited from the unlimited guarantee, which now imposes further constraints on public spending.³⁶ Of course, Wall Street routinely supplies the top US Treasury personnel, and the Icelandic guarantees were but a drop in the ocean compared to the Paulson–Geithner bail-outs of Goldman Sachs, Deutsche Bank et al. via the intravenous flows of public funds to AIG.

Iceland remains an extreme case of the dynamics that are still playing themselves out in much of the Atlantic world. Other states, too, are now rescuing the banks at the expense of the economy, by rounds of fiscal austerity that will not be compensated by expansion of the private sector. Other states, with IMF support, have agreed to take on private debt and finance its repayment out of taxes, exempting large private creditors from the discipline of the market that they champion for everyone else. Other states, too, have failed to call to account those responsible for the crisis—hardly any financiers anywhere have been prosecuted, let alone their accomplices in the treasuries and central banks. All this leaves a legacy of distrust in the core institutions of capitalism. But perhaps the biggest difference is that financial sectors elsewhere are now reasserting their dominance over their economies. Iceland has many problems ahead, but at least its banks are unlikely to run wild again.

20 September 2010

³⁶ SIC Report, vol. 5, p. 241, table 4. It should be noted that the EEA deposit-guarantee scheme only covers up to the equivalent of 3m krónur.